



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Draft

Date Introduced:	02/22/07	Bill No:	AB 728
Tax:	Sales and Use	Author:	Plescia
Related Bills:			

BILL SUMMARY

This bill would exempt from sales and use taxes sales through a vending machine of packaged candy, gum and confectionary, snack foods, and bottled water.

ANALYSIS

CURRENT LAW

Under existing law, a sales tax is imposed on retailers for the privilege of selling tangible personal property in this state. The use tax is imposed upon the storage, use, or other consumption of tangible personal property purchased in this state. Either the sales tax or the use tax applies with respect to all sales or purchases of tangible personal property, unless that property is specifically exempted. Section 6359 of the Revenue and Taxation Code provides an exemption for sales of food products, except when sold under the following circumstances:

- 1) When food products are served as meals on or off the premises of the retailer.
- 2) When the food products are furnished, prepared, or served for consumption at tables, chairs, or counters or from trays, glasses, dishes, or other tableware whether provided by the retailer or by a person with whom the retailer contracts to furnish, prepare, or serve food products to others.
- 3) When the food products are ordinarily sold for immediate consumption on or near a location at which parking facilities are provided primarily for the use of patrons in consuming the products purchased at the location, even though those products are sold on a "take out" or "to go" order and are actually packaged or wrapped and taken from the premises of the retailer.
- 4) When the food products are sold for consumption within a place, the entrance to which is subject to an admission charge, except national and state parks and monuments, marinas, campgrounds, and recreational vehicle parks.
- 5) When the food products are sold through a vending machine (but limited by Section 6359.2).
- 6) When the food products sold are furnished in a form suitable for consumption on the seller's premises, and both of the following apply:
 - a) Over 80 percent of the seller's gross receipts are from the sale of food products.
 - b) Over 80 percent of the seller's retail sales of food products are subject to tax.
- 7) When the food products are sold as hot prepared food products.

Current law provides through Section 6359.2 that only 33 percent of the gross receipts from the retail sale of food products are subject to tax when sold through a vending machine. Under Section 6363, however, tax does not apply to sales of any food products, whether sold through a vending machine or otherwise, to students of a school by public or private schools, school districts, student organizations, or any blind person (as defined in Section 19153 of the Welfare and Institutions Code) operating a restaurant or vending stand in an educational institution under Article 5 (commencing with Section 19625) of Chapter 6 of Part 2 of Division 10 of the Welfare and Institutions Code.

PROPOSED LAW

This bill would amend Sections 6359 and 6359.2 of the Sales and Use Tax Law to provide that sales of packaged candy, gum, and confectionary, snack foods, and bottled water through a vending machine are exempt from tax.

This bill would also define the term “snack foods” to mean cookies, crackers, chips, snack cakes and pies, pastries, pretzels, granola snacks, popcorn, fabricated chips and snacks, trail mix, nuts, edible seeds, dried fruit snacks, meat snacks, and snack mixtures. Except for popcorn, snack foods would only include items that are sold in a condition suitable for consumption without further processing, including, but not limited to, cooking, heating, or thawing.

The bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill is enacted.

BACKGROUND

Sales of cold food products for home consumption are generally not subject to tax. When food is sold for consumption at facilities provided by the retailer, however, the sale is taxable. In the case of vending machine sales, since the retailer is unable to determine whether food sold is consumed on or off the premises where the vending machine is located, a standard approximation of the amount of food consumed at the vending machine site was established in law. Accordingly, in order to minimize the vending machine operators’ reporting problems, Section 6359.2 was added into law to provide that 67 percent of cold food products sold through vending machines are exempt from tax and that 33 percent of cold food products are considered to be consumed at facilities of the retailer and are therefore taxable.

In 1983, Section 6359.2 was repealed and 100 percent of the gross receipts from the sales of cold food products through vending machines were taxable.

Section 6359.2 was added in law again in 1988 to provide a partial exemption for cold food products sold through vending machines. Due to revenue considerations, the exemption was phased in during 1988 and 1989. During 1988, 77 percent of the gross receipts from the sales of food products sold through vending machines were subject to tax. During 1989, 55 percent were subject to tax, and, beginning in 1990 and thereafter, 33 percent of the gross receipts from the sales of food products sold through vending machines were subject to tax.

Four similar measures were considered in the 1999-00 and 2001-02 Legislative sessions: Assembly Bill 890 (Floyd, 1999) and AB 1427 (Nation, 2001) died in the Assembly Appropriations Committee, and AB 2824 (Cardoza, 2000) and AB 893 (B. Campbell, 2001), died in the Assembly Revenue and Taxation Committee.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

COMMENTS

1. **Sponsor and Purpose.** According to the author's office, who is also the sponsor of the bill, the purpose of this measure is to create an exemption for sales of snack food and candy sold through vending machines so that the same exemption applies to sales of these products as sold by other retailers, such as grocery stores.
2. **What is a snack food?** This bill defines the term snack food to mean "cookies, crackers, chips, snack cakes and pies, pastries, pretzels, granola snacks, popcorn, fabricated chips and snacks, trail mix, nuts, edible seeds, dried fruit snacks, meat snacks, and snack mixtures. Except for popcorn, snack foods would include only items that are sold in a condition suitable for consumption without further processing such as cooking, heating, or thawing." Sales of bulk items (e.g., handful of nuts, candy, or gum) are not included in the proposed exemption.
3. **Sales of carbonated beverages would still be subject to tax.** Since carbonated beverages are not included in the definition of food products or snack food products, sales of carbonated beverages would still be subject to tax when sold through a vending machine, consistent with sales by other retailers.
4. **How much snack food is consumed on the premises?** The purpose of the bill is to create equal tax treatment between vending machine operators selling candy and snack food and other retailers selling the same products, such as convenience stores. The purpose for taxing 33 percent of the gross receipts of vending machine sales is to tax the approximate amount of products consumed on the premises of the vending machine. According to the California Automatic Vendor's Council, the percentage of candy and snack food consumed on the premises is very small, and therefore, such sales should be exempted from the computation of tax. Since these items are packaged goods, they are more likely to be taken elsewhere for consumption by the purchaser. Other types of food items sold through vending machines, such as cold sandwiches, fruit, vegetables, dairy products and juices are more likely to be consumed on the premises, and 33 percent of the gross receipts from the sales of these products would remain subject to tax under this bill.
5. **Bill could make reporting for vending machine operators more difficult and add confusion.** Under current law, vending machine operators must segregate their sales between food products and non-food products. Currently, 33 percent of the gross receipts from vending machine sales of food products are subject to tax, and 100 percent of the gross receipts from vending machine sales of non-food products are subject to tax. This bill will create a third category of items - snack foods - that vending machine operators must segregate in their records. Also, beverages would need to be segregated into 3 categories to determine the amount of taxable gross receipts (carbonated beverages are fully taxable, non-carbonated beverages are 33% taxable, and with this bill, bottled water would be exempt). Other areas of confusion include, for example, whether such items as ice cream bars or popsicles would be regarded as a snack food, or whether a handful of candy would be included (nuts appear to be included within the proposed exemption, but not a handful of candy). This could further complicate reporting for vending machine operators and could lead to additional reporting errors.

6. **Proposition 163 does not appear to affect this bill.** In 1992, voters passed Proposition 163, which, among other things, repealed the “snack tax” law. The snack tax was repealed by amending Section 6359 to include snack food items within the definition of food products. Additionally, Section 34 was added to Article XIII of the California Constitution to prohibit the State of California from levying a sales or use tax on the sale of food products for human consumption, except as provided by statute as of the effective date of that section.

Article II, Section 10(c) provides that an initiative statute may be amended by the Legislature without a vote of the people only if the initiative statute so provides. Commonly, language is included in the initiative statute that the Legislature may amend the statute without voter approval only if the proposed amendment furthers the purposes of the initiative. While the language of Proposition 163 did not contain this formula, Section Four of the initiative provides that Section 34 supersedes all other Constitutional provisions in conflict with it. Section 34 only prohibits the levying of a new tax on sales of food but does not prohibit the granting of a new exemption. Since this bill would grant a new exemption and further the purposes of the initiative statute – to limit sales and use taxes on sales of food products – a reasonable interpretation of Section 34 is to permit such amendment without voter approval. As a result, voter approval is not needed to enact the amendments proposed by this bill.

Since tax upon the sale of food products for human consumption through a vending machine was included in Section 6359 at the time Proposition 163 was passed, it appears that any subsequent repeal of this proposed exemption and reinstatement of the tax on 33 percent of the sales through a vending machine would not be in violation of Section 34 as well.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers, answering inquiries, and amending appropriate regulations. A detailed cost estimate of the workload impacting data entry, verification, and return processing is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The 2002 Economic Census data reported \$611.1 million in vending machine sales in California. The following depicts a breakdown of the total \$611.1 vending machine million sales:

California vending machine sales:

- NAICS 4542 – Vending machine operators (firms with payroll) \$496.6 million
- NAICS 4542 – Vending machine operators (non-employers) \$114.5 million

The \$611.1 million represents all of the items sold via vending machines. As stated earlier, this measure only exempts sales of packaged candy, gum, confectionery, snack foods and bottled water from the imposition of the tax. The National Automatic Merchandising Association (NAMA), a national trade association representing the vending, coffee service and food service industries, estimates that these items represent 40% of sales out of vending machines.

Applying the 40% estimate, it is estimated that total packaged candy, gum, confectionery, snack foods and bottled water sales would be \$244.4 million (40% × \$611.1 million = \$244.4 million).

Currently, 33% of these sales are subject to tax. Therefore, estimated sales subject to the provisions of this bill would amount to \$80.7 million. (33% × \$244.4 million = \$80.7 million).

According to NAMA, although there was a 4.4% growth in 2004 and 3.1% in 2005 in the U.S., growth in the Western region (including California) was much less than the U.S.

REVENUE SUMMARY

The annual revenue loss from exempting \$80.7 million in sales of packaged candy, gum, confectionery, snack foods and bottled water through vending machines from the sales and use tax would be as follows:

	<u>Revenue Loss</u>
State loss (5%)	\$4.0 million
Fiscal Recovery Fund loss (0.25%)	0.2 million
Local loss (2.00%)	1.6 million
Special District loss (0.69%)	<u>0.6 million</u>
Total	<u>\$6.4 million</u>

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